

# An Investigation into Contemporary Issues of the Statutory Audit for Small Firms

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## 1 Introduction

### 1.1 Introduction

In light of the recent implementation of the Statutory Audit Directive (2006/43/EC), changes have been made to the way the statutory audit is conducted. The researcher wishes to examine what impact this law is having on audit firms and how they are reacting to the changes made by it.

The researcher also wants to examine what changes the auditors would like to see made to the current audit process to improve it for investors, owners and other stakeholders.

It is of interest to the researcher to investigate the existence of any potential risks to the future of the statutory audit in its current form. These issues form the basis of the research questions of this dissertation and are listed below. The researcher aims to conduct primary research in the form of interviews with auditors, in order to attempt to answer the questions.

### 1.2 Research Questions

There are three research questions to this exploratory study:

1. In light of the recent Statutory Audit Directive (SAD) 2006/43/EC of the European Parliament and the Council, what effects will it have on the auditing process in your firm?
2. Given your experience of the current audit process, what changes would you like to see implemented in the auditing process?
3. In your opinion, what are the biggest risks to the future of the auditing process in your firm and what are possible ways to negate these risks?

### 1.3 Rationale for Research

The purpose for conducting this research was to gain an insight as to how the recent changes of the Statutory Audit Directive (2006/46/EC) are being received by the profession, what changes they feel needs to be made to the Statutory Audit process and what are potential risks to the future of the Statutory Audit.

#### Rationale for Research

The rationale for conducting this research is the fact that these are turbulent times for the Statutory Audit, with changes recently implemented and further changes proposed by the European Union for the future.

The changes that have been recently implemented are the biggest changes to occur to the Statutory Audit process in recent times. The ability for firms to incorporate their auditing practises is a landmark development, a move away from the traditional set-up of partnerships. Thus, the researcher wants to examine how these changes signed into law by the Statutory Audit Directive (2006/46/EC) are being received by the auditing profession and what impact they are having on individual firms. The researcher found a lack of literature in the area so thought this was an important area requiring research.

The proposed changes put forward by the European Union will further modify the way the Statutory Audit is conducted. These proposed changes are at an early stage, with the European Union welcoming discussion from interested stakeholders, the researcher feels that it is necessary to get the opinions of members of the profession as to how successful they think the proposed changes would be, and if they would detract or improve the current process.

The final area of the research concerns potential risks to the audit process. These are important to discover so as safeguards can be implemented to reduce the effects of these risks on the profession, and

to protect the future of the statutory audit. The researcher felt that members of the auditing profession were well situated to offer opinions on what are potential risks they feel which could negatively affect the Statutory Audit.

#### 1.4 Potential Uses and Limitations of the Research

The researcher has identified the following potential users of the research.

The professional accountancy bodies could use the research to tailor their education programmes for their students to enable that they are up to date with the latest developments in the auditing sector. These bodies could also make use of the research to stimulate debate on certain issues arising in the research for instance, possible developments on the future of the Statutory Audit.

Law-makers and regulators could use the research for this purpose also. They can take on board the recommendations made as a result of the research conducted to make amendments to the Statutory Audit process to make it more effective for stakeholders.

The researcher believes that the research could be used to inspire debate amongst fellow academics and scholars in the area and to assist them with their own research.

Accountancy firms could use the research to discover how other members of the profession felt about recent changes and proposed changes to the Statutory Auditing process.

The researcher has identified the following limitations of the research. Firstly, the researcher was constricted by a lack of resources. With regard to time, the research was conducted over the course of the academic year and in partial fulfilment of the requirements of the Master of Arts in Accounting, so this had to be taken into consideration when planning and conducting the research.

The researcher also had a limited budget, affecting the scale of the investigation by the number of respondents who could be interviewed and the location of the respondents, as the researcher had to use subjects who proximate. A large scale investigation could not be conducted.

There is the possibility of researcher bias in interpretation of responses as the information is of a qualitative nature, and relatively subjective in nature. There may be researcher bias with preconceptions about the topic being investigated.

### 1.5 Chapter Outline

There follows a presentation of the Literature on the topic in chapter 2. The methodology of the primary research conducted is detailed in chapter 3. The findings of the primary research are presented in chapter 4. The researcher presents the recommendations and conclusions derived from the findings in chapter 5.



## 2 Literature Review

### 2.1 Introduction

The purpose of this chapter is to detail the problems about which research is to be undertaken.

### 2.2 History of the Audit

The main reason for an audit is the "Agency Theory" concept. The "Principal" (providers of capital, shareholders) have different interests from the "Agents" (users of that capital, management/directors). Nolan M. (2010) suggests that the growth of publicly-owned companies after the "Industrial Revolution" has resulted in greater separation of owners and management.

A supplementary justification is the enhanced credibility the audit provides to the financial statements of the company as derived by the auditor's qualification and the ability of the audit to enhance decision-making of directors (Cosserat & Rodda 2009).

The annual accounts of limited liability companies are now required to be audited under European Law (Fourth Council Directive 78/660/EEC, Seventh Council Directive 83/349/EEC, 86/635/EEC, 91/674/EEC). As Ireland is a member of the European Union, we subscribe to this. Section 160 of the Companies Act 1963 requires all companies to appoint an auditor. However, Section 32 of the Companies (Amendment) (No. 2) Act 1999, as amended by Section 53 of Companies (Auditing and Accounting) Act 2003 and Section 9 of Investment Funds, Companies and Miscellaneous Provisions Act 2006, states that companies meeting certain criteria are exempt from the statutory audit. The criteria are as follows: average number of employees for the period not greater than 50, turnover not exceeding €7.3 million and Balance sheet total does not exceed €3.65 million.

## Overall Objective

ISA 200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing (APB, 2010), defines the objective of a financial statement audit as follows:

*"The purpose of an audit is to enhance the degree of confidence on intended users in the financial statements. This is achieved by the expression of an opinion by the auditor on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework."*

(APB (2010), P: 246(3))

By its definition, the audit proposes conflicts.

Firstly, who are the "intended users" of the FS? Does the report apply solely to current shareholders, potential future shareholders, suppliers, lenders of credit? The "stakeholders" (interested parties) involved need to be known for liability consequences as the auditor may have a duty of care to these parties. There have been many cases throughout the years regarding this issue. For example, Royal Bank of Scotland versus Bannerman, Johnstone & MaClay [2005] and Caparo Industries plc v Dickman [1990].

In Caparo, it was held that an auditor had a duty of care to a third party if they knew the identity of the third party, knew the nature of the contemplated decision (i.e. making an investment), that the advices or information would be passed to a third party and that it was very likely that the third party would rely on that advice. It was rejected that the auditors owed a duty of care to all prospective investors or individual shareholders (Keane 2008).

In the case of "Bannerman", the court found against the auditor that they had a duty of care towards RBS, based on rulings in the "Caparo" case (ACCA (2008)).

As a result of this many of the professional accountancy bodies (CAI, ICAEW, ICAS & CPA) advised their members to include a "Bannerman" paragraph or a disclaimer which negates liability to third parties.

This is the most recent change and shows a precedent that the audit process and reporting requirements can change.

The second problem that arises is "expression of opinion". The auditor does not "certify" the FS of the company, they merely give an opinion. This is because of the use of "sampling" as a technique of gathering audit evidence. The auditor does not look at every transaction of the company, but a sample of transactions. This is because the additional costs of checking every transaction would outweigh the benefit achieved. ISA 530: Audit Sampling (APB, 2010) provides auditors with guidance in selecting an appropriate sample, in an attempt to negate the risks of sampling, such as misstatements found in the sample, the sample being representative of the entire population and methods of sample design, size and selection.

"Materiality" is the third issue that arises from the definition. This is how important a single item is in the FS, and the degree of accuracy to which the auditor works. ISA 320: Materiality in Planning and Performing an Audit, (APB, 2010) states that a "misstatement, or omission, is material if they individually or in aggregate could reasonably be expected to influence the decisions of users".

The "applicable financial reporting framework" is the final area which causes concern. This is the laws and regulations to which the FS are prepared. These may cause problems if users of the FS are not familiar with their contents. They pose a problem for auditors, who must be familiar with their contents to ensure they are not giving a wrong opinion stating a company is compliant when they are not.

An "Expectation Gap" arises as a result of these issues (Liggio (1974) is credited by Boyd (2000) as the first user of this term). Cosserat and Rodda (2009) acknowledge that auditing practises have evolved since the early 1990s in response to growing public expectations of accountability; however regardless of this a gap continues to exist. Directors and/or shareholders may believe that the auditor does certify that the FS are free from all misstatements and no fraud is taking place in the company. However the opinion is based on the results of the "sample".

Nolan R. (2010) presents the notion of an "accounting (policy) expectation gap" as well as an audit expectation gap, which would increase the gulf in notions of what is provided by the service.

As a result of these "Gaps", the audit profession can come in for criticism, when they issue "clean" or unqualified opinions on companies who fail or go out of business in the period subsequent to the audit. However the auditors may well have fulfilled their obligations in relation to conduct of the audit.

Costello (2010) acknowledges that this "Gap" is the traditional defence of the industry and raises the question if fulfilling their statutory requirements with regard to the audit is sufficient or should firms be more proactive with issues of independence and issuing opinions. It appears that Costello (2010) feels auditors should take more responsibility and strive for better segregation where issues surrounding independence and quality of the opinion occur.

The above issues are recognised as inherent weaknesses of the audit. Regulators and law-makers try to combat these by remaining active in modifying the audit process to make it better fit end-users needs.

### 2.3 The Nature of the Statutory Audit

As mentioned above, the auditor uses the technique of "sampling" as a method of gathering evidence in order to express an opinion as to whether or not the books, records and accounts of the company gives a "true and fair view" (Hoffman and Arden (1983), Section 393 Companies Act 2006), that is not materially misstated. This means that the auditor may not examine every transaction in the company's accounts as this would be too time-consuming and costly. This is a common method of obtaining evidence in a "risk-based" approach to the audit, a method used to audit large companies with excellent internal controls, where examination of every transaction is difficult (Millichamp 2008).

The auditor plans the audit in accordance with guidance given in ISA 300: Planning an Audit of Financial Statements and ISA 530: Audit Sampling (APB 2010). These alert the auditor to important areas for consideration and how to develop a sample so that it is representative of the population of transactions. If an auditor's sample selection methods are inappropriate they may miss out on important misstatements and give an inappropriate opinion.

This can increase the problems associated with the "Expectation Gap".

### 2.4 Corporate Scandals

In light of the recent corporate scandals of the past twenty years, regulators have taking significant steps aimed at restoring investor confidence in the Audit. O'Connor (2011) recently stated that a "key strategic theme to ensure the viability and standing of the Institute (of Chartered Accountants, Ireland) going forward" is to repair the reputation of the profession.

The most notable scandal was Enron, where related parties were used to conceal losses by the company (Millichamp 2008), and to a lesser extent Tyco, WorldCom and Parmalat.

Auditors were heavily criticised for neglecting their duties (Wearing 2005). The independence of the audit firms was called into question. Critics argued that a firm could not give a fully unbiased, independent view, if it was receiving a significant proportion of its fees from non-audit work (\$25m for audit, \$27m for non-audit). The firms were receiving large amounts for consultancy and professional fees for tasks such as implementing computer systems (Wearing 2005).

The culmination of the Enron disaster was large amounts of investors losing their savings, job losses of the staff at the company, the demise of the accountancy and auditing firm Arthur Andersen (Wearing 2005), and the introduction of the US Sarbanes Oxley Act 2002 on Corporate Governance, prohibiting auditors simultaneously providing certain non-audit services, such as book-keeping, IT systems implementation, (Section 201, US Sarbanes Oxley Act 2002).

Disaster cases, such as Enron and other instances where auditing is in the news does increase the issuance of "going-concern" related modifications to audit reports as auditors become more conservative about their opinions (Feldmann & Read, 2010). The "going-concern" assumption is that "the entity is viewed as continuing in business for the foreseeable future" (ISA 570: Going Concern, APB, 2010) and accounts are prepared on this assumption. Therefore the audit opinion is given on this assumption. A "going-concern" modification is when the auditor is of the opinion that the entity will not be in business for the foreseeable future.

These results question the quality of audit reports in times with little incidents of auditors in the news or scandal and if auditors are performing well enough in these times. This may call into question whether or not auditors are fulfilling their duties to an appropriate standard.

The EU is taking action now through the SAD, as stated by Lambe and Kenny (2010):

*"this directive can arguably be seen as a product of the financial scandals of the early noughties such as Enron and Parmalat".*

## 2.5 Statutory Audit Directive

The European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010 were signed into Irish law on 20 May 2010. The purpose of the Directive is to strengthen and support the statutory audits role and ensure equivalent standards are applied across the European Union (McAlpine, 2010).

As a result of the Directive, the Irish Auditing and Accounting Supervisory Authority (IAASA) are now responsible for inspecting the audits of Public Interest Entities (PIEs). These are companies whose transferable securities are admitted to trading on a regulated market of any member state (of the EU) (Article 4(1) of Directive 2004/39/EC), credit institutions (Article 1 of Directive 2000/12/EC) and insurance undertakings (Article 2(1) of Directive 91/674/EEC). This is no longer a task of the Irish Accountancy bodies (Association of Chartered Certified Accountants (ACCA), Certified Public Accountants (CPA), Chartered Accountants of Ireland (CAI),). This is a move to restore investor confidence in light of corporate scandals, as it was the accountancy bodies in charge of supervision then.

Auditors of PIEs now have a requirement to issue a "transparency report" with details of governance matters (Regulation 58).

IAASA also has responsibility for overseeing how the accountancy bodies monitor the quality of statutory audits, an additional disclosure required by bodies.

However McAlpine (2010) writes that the Regulations bring statutory underpinning for the existing supervising structures rather than

change them. The effects of these on the profession are a concern for the researcher to investigate how auditors are now ensuring compliance with these rules.

Auditors now have the option of forming limited liability companies (Regulation 6). It will be interesting to see what the profession thinks about this development and its impact on improving the audit process. If auditors do form limited liability companies, then who will audit them. A member of the competition may be getting an insight into their work practises. Spicer and Fahy (2011) identify a number of benefits of incorporating an audit practice, namely limited liability, ability to sell shares and certain tax efficiencies for example corporation tax of 12.5%. However, the authors recognise some disadvantages of incorporation. There are increased administration and filing requirements and perhaps some tax issues regarding "close company" status of the newly incorporated company. The researcher feels that with the knowledge auditors possess derived from their qualification, compliance with these regulations should not prove too difficult for the company.

With regard to "Change of Auditor", amendments have been made allowing oversight of the reasons for the change (Regulation 62). The auditor and the company now have to inform IAASA when a change occurs. This may add to the administration costs for the company.

The sharing of information between predecessor and successor auditors has also been included in the directive (Regulation 47). This is an attempt to reduce risks associated with unfamiliarity in "year 1" of the audit. This may be a step towards helping reduce the "Big 4's" concentration in the market (McAlpine 2010). The issue is the unfair advantage the "Big 4" has in gaining new clients, whose shareholders perceive mid-tier firms as not qualified or experienced enough to conduct the audit of the company. This perception means the mid-tier



firms have trouble accessing this market. The Commission is concerned that in the event of a failure of a "Big 4" firm, the audit profession may suffer negatively.

### Auditor Independence

Specific prohibitions are enforced on people who are too close to the company from auditing it (Regulation 71). Where PIEs are concerned provision is made for rotation of key audit partners after seven years in that role and a rule where an audit partner responsible for the company's audit cannot take up a management role in the company within two years of leaving as auditor (Regulation 78).

Additional provisions include assessing non-audit services provided by the auditor (Regulation 120). As stated by McAlpine (2010), this adds statutory underpinning to preferred practises as recommended by the Auditing Standards.

Auditors must document in the audit working papers "all significant threats to independence and related safeguards to mitigate threats" (Regulation 73). This again is aimed at restoring investor confidence in the audit reporting process and its effectiveness in the eyes of the profession is intriguing.

Auditors of PIEs are required to annually provide written confirmation of independence to the audit committee, and discuss any threats to independence along with safeguards implemented (Regulation 72). The audit committee is the committee of independent directors charged with communication with auditors and ensuring the integrity of the FS (FRC 2010).

All remuneration to the auditors must be classified under the following headings: audit, other assurance, tax advisory and other non-audit (Regulation 120) in an effort to increase disclosure from current practises.

### Group Audits

The group auditor must take full responsibility for the audit report on group accounts (Regulation 55). An appropriate review of working papers of other auditors used in the audit must be undertaken by the main audit engagement partner. This is an extension of the work of the auditor from current requirements, as previously the group auditor was not responsible for component auditor's (other auditors used in the process) work. ISA 600: Audits of Group Financial Statements gives guidance on this.

### Audit Committees

Committees are given additional roles to monitor the financial reporting process, monitoring the effectiveness of the entity's internal control, internal audit, risk management, monitoring the statutory audit of annual accounts, monitoring the independence of the auditor and provision of non-audit services (Regulation 91).

### Signing of Audit Reports

Regulation 57 states that the audit report must be signed on behalf of the firm, personally by the engagement partner, rather than just the firm's name.

McAlpine (2010) questions whether the audit report itself should be amended to better fulfil end-users requirements. The researcher would like to investigate possible ways in which it could be adjusted.

These are the most recent and most dramatic changes that have been implemented on the auditing profession for sometime and the researcher has found very little commentary on the area. It is for that reason the researcher wishes to obtain the view of the profession on the above matters. These responses will be of critical importance and are necessary in answering the first research question to the study and will form the basis of primary data collection.

## 2.6 EU Green Paper: "Audit Policy – Lessons From the Crisis"

Lambe and Kenny (2010) comment that the "status quo" is not an option for the future of the audit. The criticisms faced by the audit community are driving a call for reform of the process. Auditors want to return the audit to a place of special importance, enhancing the credibility of an organisations FS.

This is the view of Powell (2010), who wants the "leaders" of the auditing profession to take charge and reform the process.

Powell (2010) lists the six topics PriceWaterhouseCoopers (PWC) is implementing in order to restore confidence in the audit.

Firstly, they are aiming to raise quality control of the audit process to eliminate any inappropriate opinions given on the FS.

Secondly, they are improving the transparency of scope, decision-making, processes and communication of the auditors to stakeholders, perhaps through the audit committee's report.

Thirdly, they are examining how changes can be made to reporting requirements to improve them. Powell (2010) has identified using the narrative information that goes with the audit report as a vehicle for achieving this. One issue the researcher believes may occur here is the difficulty in regulating this information. As it is supplementary to the audit report, how liable are the auditors for "signing-off" on such information if it proves to be inappropriate.

Fourth, PWC are looking to improve standards for reporting and auditing to give clearer and better assured information.

Fifth, PWC want a more long term agenda established with regulators and other market participators to reform the role of reporting and auditing in supporting a well functioning market.

Finally PWC aim to encourage their clients to offer better information regarding business strategy and performance. Again regulation of this may prove difficult.

These recommendations are similar to the issues raised in the European Green Paper issued in October 2010 regarding auditor

communication with stakeholders and perhaps add weight to the Green Paper's argument for reform in those areas.

The views of the profession to these changed work practises will be is of importance along with their views on how successful or unsuccessful they will be and if they should be implemented in all audits and preparation of FS.

It is such thinking and desire for reform that has led the EU to issue a Green Paper investigating potential reforms of the audit process. A Green Paper is a document published by the European Commission to stimulate discussion on given topics at European Level ([www.europa.eu](http://www.europa.eu)). They invite individuals or organisations to participate in the consultation process and debate on the issues they put forward. Green Papers may give rise to legislative developments that are then outlined in White Papers, which are documents containing proposals for Community action in a specific area ([www.europa.eu](http://www.europa.eu)). The paper addresses the following areas.

### Role of the Auditor

#### Communication by auditors to stakeholders

This area of the paper deals with what information the auditors should provide to the stakeholders, that is the directors and shareholders of the company. Nolan R. (2010) believes that confidence in the role of the auditor would be enhanced if there was more visibility around what took place during the audit process.

One proposal put forward is that additional communication could be made on the methodology of the audit. The Commission wants to see the audit "go back to basics". That is return to more substantive verification of the balance sheet and less reliance on the compliance aspect, which they believe should be the responsibility of the company. The Commission believes this should be achieved through the "Internal Audit" function of the company; however they may lack the required expertise. This returns us to the problem where the

auditor may be used in a "non-audit" context to verify these requirements, perhaps hindering objectivity and independence. The Commission recommends that disclosure of directly verified components should be made. This is one area where the audit report may be amended.

Costello (2010) suggests that the "Materiality" level to which the auditor works should be disclosed on the FS. This would obviously increase communication and transparency, an aim of the reforms.

#### Auditor behaviour

The Commission wants to see the auditor become more questioning and sceptical of management's representations with regard to the FS, issuing "emphasis of matter" paragraphs where necessary. The auditor uses this option to draw attention to certain elements of the FS, for example going-concern issues or potential litigation the company faces (Nolan M., 2010). The researcher feels that the Commission wants this option more aggressively followed. This is not a new element of the report; however, if it is used more aggressively can aid disclosure and communication to the stakeholders.

#### The Audit Report

The Commission questions the negativity associated with a "qualified" audit report. The Commission feels that a statement on the "relative performance" of the company and a report on the "potential risks, sectoral evaluation, commodity and exchange rate risk coupled with the auditor's report may bring more value to stakeholders.

Further areas of disclosure to these have been suggested by the Chartered Accountants of Ireland (2011) such as corporate governance disclosure and operation of internal controls. Nolan R. (2010) questions the ability of general purpose financial statements to satisfy the needs of all stakeholders of the company and suggests the issue of additional "tailored" reports or narrative comments made by the author.

Nolan R. (2010) surmises investor's willingness for the audit committee to report in the annual report of the company in a bid to improve investor confidence.

One issue that may arise here is the increased costs associated with providing such reports. This may be perceived as not adding sufficient value to the FS of smaller companies, perhaps which are owner-managed compared with the cost incurred.

The IOSCO and IAASB are both currently questioning how the report can be improved (Green Paper).

### Communication

The Commission feels that better communication between auditors and stakeholders may improve the quality of the audit.

The Commission cites the German legislation's requirement for auditors to provide a report to the directors where they summarise in greater detail than the audit report the findings of the audit.

The researcher would question if this should be made available to shareholders also.

### Extension of Auditor's Mandate

The audit of FS is on an historical basis. The Commission raises the question whether auditors could take a more forward looking approach to examination, in addition to "going concern" issues. This could be achieved issuing reports on internal controls, risk management techniques or innovation procedures employed by the company.

### Governance and Independence of Audit Firms

The Commission questions whether the auditor appointment of large companies and/or systemic financial institutions should be the task of a third party. Whilst conceding this would increase bureaucracy, increased societal benefits may be achieved. Some difficulties would

be how the process would work, how the third party got paid, independence, liability, increased costs as third party may have to make a profit.

The Commission wishes to examine the issue of mandatory rotation of audit firms – not just partners. The Commission feels this is necessary to give the impression of complete independence. Currently legislation provides for rotation of partner after seven years where the company is a listed company. However there may be increased costs associated with this. Regulation 47 of the SAD may help reduce this burden as auditors are now obliged to provide information to successor auditors.

#### Non-Audit Services

In France, and the US as a result of Sarbanes Oxley 2002, a total ban of auditor providing non-audit services to audit clients is in operation. This is left to the discretion of national governments to decide in other EU member states. The Commission is examining whether a total ban should be applied throughout all EU member states.

Costello (2010) feels the end result of this may be the creation of "pure audit firms". The impact of this on competition and cost needs to be examined. However "pure audit firms" may reduce the "Expectation Gap". The views of the profession on these matters will be useful in examining potential changes to the process.

#### Supervision

The Commission wishes to see increased dialogue between the regulators and the auditors. This may not be to the pleasing of the audit profession; however increased supervision is an important aspect of increasing user confidence in the audit report.

### Concentration and Market Structure

The Commission is concerned at the inability of mid-tier firms at breaking the "Big 4's" hold on the market for audit of listed companies. They have proposed the concept of "Joint Audits", currently enforced in France, where listed companies are required to appoint two firms of auditors who are required to both sign-off on the audit report. They hope that this will help mid-tier firms enter the market, by perhaps not allowing two "Big 4" firms to work on an audit. "Big 4" firms may not be happy about this as they may be giving away some of their expertise to their rivals. Research by Chang, et al (2010) shows that after the Enron Crisis and subsequent introduction of the Sarbanes Oxley Act 2002, smaller firms became more successful in attracting companies over their "Big 4 " rivals, due to increased regulation increasing audit quality and because such a large firm as Arthur Andersen could fail. The Commission may hope changes implemented may have a similar effect in Europe.

As mentioned, one key fear the Commission holds for the future of the audit is the demise of a member of the "Big 4". Allowing mid-tier firms to demonstrate their ability to perform quality audits may be a way of negating this fear to a certain extent.

### Mandatory Rotation

The Commission sees mandatory rotation of audit firms as well as auditors as a way of enhancing independence of auditors. This is to prevent a familiarity threat occurring where the auditors become too close too management/directors, losing their objectivity and scepticism.

The Commission wants mandatory tendering for audits with full transparency of the criteria to which the auditor will be appointed. Quality and independence should be key selection criteria.

The Commission wants to examine the issue of "Big 4 only" covenants demanded by certain financial institutions, as reported by Christodoulou (2010). One possible remedy to this might be the



creation of a European Quality certification to demonstrate firms with the ability to conduct audits of these large companies.

#### Creation of a European Market

The Commission proposes a "European Passport" for auditors to move between member states, as a way of breaking down "barriers to entry" for auditors. Such barriers as Articles no.3 and no.14 of the Directive, which require approval and registration in each state and an aptitude test to be undertaken.

The Commission feels this would encourage more competition in the market for large audits because it would simplify the development of European audit networks along with reducing the costs of providing audits on a Europe-wide basis.

However, care needs to be given that the "Big 4" do not create an even bigger hold on the market, as transfer of skill and people would prove easier for them, perhaps resulting in scale economies with training and opportunities for travel.

#### Simplification: SMEs

While recognising benefits to SMEs such as enhanced credibility of financial information, the Commission understands that the statutory audit can be an "administrative burden".

The commission proposes the creation of a specific environment for the SME audit by discouraging the statutory audit, implementing a "limited-audit" or "statutory review", where auditors would perform limited procedures so as to detect misstatements due to fraud or error. The views of the banks to this would be imperative as very often an audit is undertaken to gain access to credit (Tauringana and Clarke (2000), Collis, J., Jarvis, R. and Skerratt, L. (2004)).

### Simplification: SMPs

If a "limited audit or statutory review" is implemented for SMEs, the Commission would like to see regulation proportionately reduced, so as not to over-burden SMPs with administrative costs.

These are the issues raised in the Green Paper and are potential changes proposed by the EU. This issue forms the basis of the second research question of the dissertation and therefore the researcher wishes to get the respondent's opinions on these as viable options for change and to see what they feel will be most successful. The researcher also proposes to give the respondents the opportunity to put forward their own proposals as to how the Statutory Audit process could be improved.

One limitation of the Literature Review has been the difficulty in presenting an unbiased view of the topic of reform of the statutory audit. This may be attributed to the fact that, in its current form, the statutory audit process is deemed no longer fit for purpose, and hence in need of reform, a view reinforced by Lambe and Kenny (2010). Therefore there is no contemporary literature available in support of the audit in its current format. This is the most likely reason, backed up by the fact that the European powers have amended the process by implementing the SAD. One aim of the process has been to restore the confidence of end-users in the audited financial statements (FS) of an entity.

It is for the above reason that the researcher has decided to undertake research in the area with the aim that it may be used in support of this reform process.

## 2.7 Potential Risks to the Future of the Statutory Audit

The final research question deals with the topic of potential risks to the future of the Statutory Audit. The researcher feels it is important to get the views of the individual as to what they feel are the most pressing risks which could jeopardise the future of the audit practise. These individuals are best placed to provide the researcher with this information. The researcher feels that possible examples could be the possible occurrence of another Enron-type scandal or the auditor failing to identify certain frauds.

In light of the contemporary debate on change associated with the current statutory audit process, the researcher feels that if certain risks could be identified from the research, then these should be taken into account by the regulators and law-makers, and if possible make amendments to protect the future of the auditing profession, safeguarding both jobs and the integrity of the audit process and report.

Due to certain limitations already mentioned in the Introduction chapter, the researcher feels it is necessary to conduct this research with relatively small audit practises, proximate to the researcher and to examine the impact of these issues on their practises.

## 2.8 Conclusion

The researcher intends to conduct primary research by interviewing auditors to obtain their views on the above issues, so that answers may be derived and presented in the dissertation. It is central to this study that the opinions of the profession on the SAD and Green Paper are explored and examined to determine the effectiveness of changes made and of any proposed changes which may be made to the auditing process, in order to improve investor confidence in the process. It is also of interest to the researcher to obtain the

profession's views on any potential risks to the future of the statutory audit so that safeguards may be developed to protect it.

The research methodology used by the researcher will now be outlined in the following chapter.

### 3 Research Methodology

#### 3.1 Introduction

This chapter outlines the research philosophy this dissertation is set in. The data collection methods are detailed along with data analysis techniques adopted by the researcher. Possible limitations of the research are presented.

The aim of this chapter is to detail why the researcher has adopted the specified techniques for data collection and analysis.

Research is a process of inquiry and investigation that is systematic and methodical, undertaking to increase knowledge in an area (Collis & Hussey 2003).

Qualitative research is an inquiry process of understanding based on a distinct methodological tradition of inquiry that explores a social or human problem. The researcher builds a complex, holistic picture, analyzes words, reports detailed views of informants and conducts the study in a natural setting (Creswell 1998).

#### 3.2 Research Questions

There are three research questions to this exploratory study:

1. In light of the recent Statutory Audit Directive (SAD) 2006/43/EC of the European Parliament and the Council, what effects will it have on the auditing process in your firm?

The aim of this research question will be to query what impact, if any, the SAD will have on the audit process in the subjects firm and if in their opinion these will be for the betterment of the process or if they will detract from the current process.

2. Given your experience of the current audit process, what changes would you like to see implemented in the auditing process?

The issuance of a "Green Paper" may be the instigation of further change to the statutory audit process. This study is concerned with investigating the individual's opinions, given their experience in their own firm, on what they would like to see changed in the statutory audit process, under these areas.

3. In your opinion, what are the biggest risks to the future of the auditing process in your firm and what are possible ways to negate these risks?

Discovering any potential risks to the future of the statutory audit process is important, as appropriate safeguards could be put in place to reduce such risks somewhat. The researcher intends to get the opinions of the subjects to these risks, assess their viability and seriousness, the effects of these risks if left unconstrained and investigate possible ways to negate the adverse affects of these.

### 3.3 Research Philosophy

Creswell (1998) believes that qualitative researchers approach their studies with a certain "paradigm" – which is a basic set of beliefs or assumptions that guide their inquiries. Guba and Lincoln (1988) as cited by Creswell (1998) states that this paradigm is influenced by certain factors.

"Ontological" issues dealing with the nature of reality. This is how the researcher views the area of research and has an influence on which data collection methods should be used.

"Epistemological" is the relationship between the researcher and that being researched.

"Methodological" refers to the research process.

### Quantitative versus Qualitative

Hair et al (2007) has identified the following characteristics are typical of qualitative data. It is more useful for discovering new information. It provides in-depth information on a few characteristics. It uses more unstructured data collection techniques requiring subjective interpretation. There is less concern for representativeness. An emphasis is placed on the trustworthiness of respondents. The researcher conducts relatively long interviews with small sample sizes. The interviewer actively probes for responses. Results are relatively subjective. Quantitative data demonstrates the opposite of the above characteristics.

### Positivism

This is on one extreme of the research paradigm continuum. The characteristics of this paradigm are that it is largely quantitative in nature. It developed from the physical sciences and uses statistics to prove/disprove predetermined hypothesis to be tested under controlled conditions (Kumar 1996). This is seen as a deductive approach to presentation of results.

Collis and Hussey (2003) have identified the following criticisms of the positivistic paradigm in that it treats people as being separate from social contexts and does not take account of their perceptions. It has a highly structured research design which imposes constraints on the results.

### Interpretivism

The opposite paradigm is the interpretivist approach. This approach is more qualitative in nature (Kumar 1996). The characteristic of this approach is that it seeks to explain human behaviour or perceptions. It is more subjective than positivism and requires more "interpretation" from the researcher's perspective as there is little or

no statistics used. There is often a lack of generalisability of results which could be attributed to the entire population. It uses an inductive approach and attempts to identify patterns to produce results (Mason 2002).

### Philosophy Adopted

The researcher has implemented an interpretivist approach to the dissertation as this is more suited to obtaining the relevant qualitative data relating to the research objectives and questions, for exploring the opinions and perceptions of the auditing profession. There will be four semi-structured interviews, using interviewer interpretation of their opinions in the Findings and Analysis chapter which follows. This is a subjective approach and may be biased by the researcher.

### 3.4 Research Focus

There are three broad classifications of research: Exploratory, Descriptive and Explanatory.

#### Exploratory

Hair et al (2007) recognise that this approach to research is useful where a better understanding of the problem is required. It is designed to explore opinions on the proposed issue, to gain a deeper understanding of the problem. Collis and Hussey (2003) suggest that it is useful where no previous study has been undertaken in the area.

#### Descriptive

Hair et al (2007) state that descriptive research is used to obtain data that describes the characteristics of the research area.



### Explanatory

This type of research aims to clarify why there is a relationship between two aspects of a problem (Kumar 1996) and to understand the problem (Collis and Hussey 2003).

### Research Focus Adopted

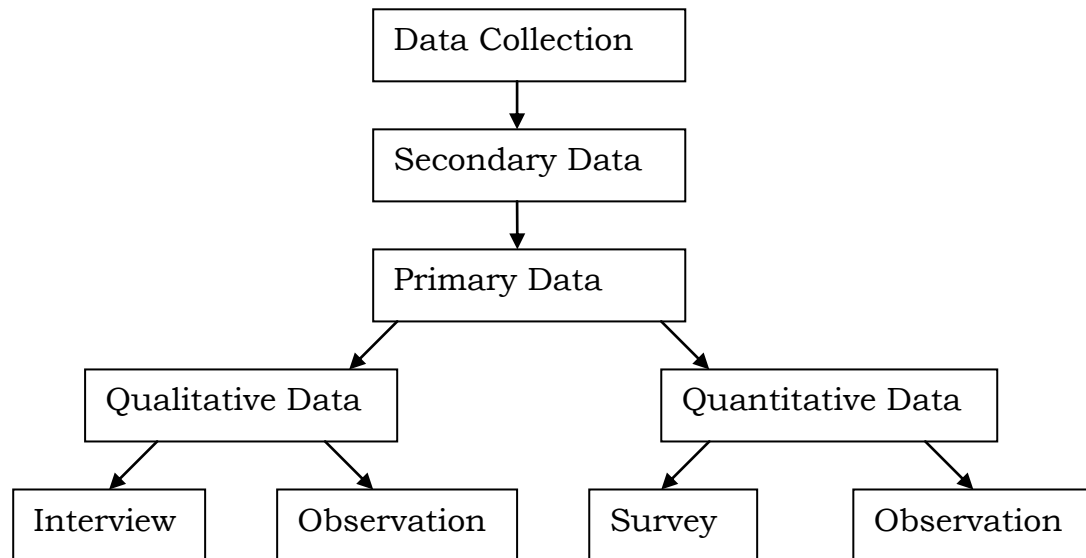
The nature of this dissertation will be Exploratory, as the researcher aims to gain an insight into the opinions of the audit profession on the issues raised in the research questions. An Exploratory approach is useful as there has been no previous research carried out on the area. There are elements of descriptive research as the researcher aims to describe how the changes have impacted on the audit profession.

### Sampling Technique

The sampling technique employed by the researcher will be convenience sampling, which is selecting sample elements that are most readily available to participate in the study and can provide the information required.

### 3.5 Data Collection Methods

Hair, et al (2007) has identified the following data collection methods suitable for qualitative data and quantitative data.



Hair, et al. (2007:192)

As the researcher is investigating data of a qualitative nature the two methods of data collection applicable are Observation and Interviewing.

#### Observation

As identified by Hair et al (2007), observation is a method of gathering qualitative data. This involves examining individuals over a period of time. However this would not be an appropriate method of data collection for this dissertation as the researcher aims to gather the opinions and perceptions of subjects not there actions and behaviours where observation is more useful for collecting such data.

#### Interviews

This is where the researcher speaks directly to the respondent. Mason (2002) has identified the following characteristics of interviewing.

There is an interactional exchange of dialogue. Interviews are relatively informal in style and approach. Interviews require themes or topics to which they will follow, in order that the researcher gains the relevant information from their subjects. The use of interviews can make comparing findings easier (Collis and Hussey 2003). The subject is a source of knowledge to the researcher and their perception of the research area is important to the researcher.

As previously stated the ontological position of the researcher is reflected in the method. Interviews are particularly helpful in gathering data when dealing with complex issues and are characteristic of a qualitative, interpretivistic approach. The use of open-ended questions allows subjects to respond freely and does not limit their responses to pre-determined options.

Mason (2002) recognises that the use of interviews means the researcher is going to be active and reflective in the data generating process, rather than a neutral data collector.

The researcher has decided to use interviews as the method of data collection as the researcher is looking to gain the perceptions of the audit community of recent changes to the statutory audit process, potential future changes to the statutory audit process and potential risks to the future of the audit.

### Unstructured Interviews

These are interviews where the researcher conducts the interview with no rigid plan. These can be time consuming and may result in subjects being asked different questions, making comparing and analysing results difficult (Collis and Hussey 2003).

Mason (2002) is critical of the terminology "unstructured" as she believes that the interview must have some structure in order to ensure that sufficient appropriate data is collected for the purpose of the research.

### Structured

These interviews follow a structured predetermined construct, where the subjects are asked identical questions.

### Semi-structured

These interviews are situated between structured and unstructured. The researcher will have a predetermined set of questions or theme sheet which they intend to ask the respondents, but have the freedom to omit or add additional questions as they see fit, as the interview progresses.

### Tape Recorded Interviews

The interviewer, with the permission of the subject may tape-record the interview for future analysis and reference. Some commentators believe that this may hinder the relationship between the researcher and subject as they become conscious of the recording of the interview. These may be transcribed and presented in an Appendix to the dissertation.

### Semi-structured Interviews

The researcher feels that the use of semi-structured interviews is appropriate for this exploratory study. Semi-structured interviews give the researcher the freedom to ask probing questions to gain the appropriate responses from the subjects in order to satisfy the research questions. The questions asked can be open-ended which does not restrict the respondent to relatively short, even yes/no answers as used in many questionnaires, which may detract from the quality of the information obtained.

The interviews will be planned and questions developed in order that the researcher is confident appropriate data will be collected from the respondents.

The researcher aims to conduct the interviews in the auditor's offices to ensure they are comfortable in their surroundings, enhancing the data collected.

The researcher proposes to let the subjects see the questions in advance of the interview in order that they are better prepared to provide higher quality responses.

### Secondary research

This will constitute analysis of relevant academic journal, publications, books and other sources of interest to the researcher concerning the research area in order to present the Literature Review chapter, which aims to justify the area of research.

### 3.6 Data Analysis

The method of data analysis to be used in the dissertation will be the researcher interpreting the subject's responses. This involves using Comprehension, acquiring a full understanding of the content and Synthesising, drawing together different themes. These elements have been identified by Morse (1994) as cited by Collis and Hussey (2003). The subjects will be quoted or paraphrased in order to present data collected in the following Findings and Analysis chapter.

### 3.7 Conclusion

This chapter aims to detail how the researcher conducted their research in order that the research questions can be answered. The data collected will now be presented in the Findings and Analysis chapter which follows.

## 4 Findings and Analysis

### 4.1 Introduction

Chapter four studies and analyses the results obtained from the primary research conducted by the researcher. This involves examination of the transcripts of the interview conversations carried out with the subjects. This allows the researcher to present the findings in order to attempt to satisfy the aforementioned research questions of the dissertation.

### 4.2 Analysis of Interview Findings

The researcher conducted three depth interviews with local auditors in order to gauge the perceptions of the recent Statutory Audit Directive and the impact it has had on their practise. It was an aim of the research to determine what changes, if any, the subjects felt were important to make in order to improve the auditing process for companies. The researcher also wished to determine what the subjects felt are the biggest risks to the auditing profession moving forward into the future.

The researcher used a list of predetermined questions as a guide in order to collect the relevant information to satisfy the research questions. However the interviews were semi-structured in nature to allow the researcher the freedom to ask additional questions which came to mind in light of the subjects responses and to allow for further interrogation. The subjects were assured of their anonymity at the beginning of the interviews. Transcripts of the interviews can be found in the Appendices section of this dissertation.

### 4.3 Presentation of Findings

The first question the interviewees were asked was to gauge the scale of the firm and the number of audits they conduct every year.

Interviewee A: There were two employees and the practise conducts 10 or 12 audits per year.

Interviewee B: There were 15 employees and the practise conducts 40 audits per year.

Interviewee C: There were 19 employees and the practise conducts 40 audits per year.

The researcher felt this was important to ask to ensure the respondents were qualified to answer questions based on actually conducting audits and to see how active they were in the industry.

In order to satisfy the first research question regarding the Statutory Audit Directive the researcher discovered the following findings.

The interviewees were asked if they were aware of the recently implemented Statutory Audit Directive (2006/43/EC) and what it entailed.

All respondents were aware of the Directive, with *Interviewee A* stating that *"audit firms can now incorporate. It also states that an individual must sign the audit report issued for the company. There is now a duty that auditors must provide Transparency Reports when auditing certain large entities. There is also the requirement to provide information to new auditors"* and Interviewees B and C acknowledging the personal signing of the reports and the option of incorporation.

The researcher felt this was an important question to examine if the respondents were aware of the Directive, the issues contained in it and its impact on their firm, as this is an important area for the dissertation, central to the first research question.

The respondents were then asked if they would incorporate the auditing section of their firm.

Interviewees A and C responded that it is currently being examined by the partners in the firm at present and that they will decide on it in the near future. All respondents acknowledged the low rate of Corporation Tax and Limited Liability as advantages of incorporation. Interviewees A and C acknowledged that the distinct disadvantages

were the additional "*Company Secretarial obligations*". Interviewee B explained that their practise will not be incorporating the auditing section of the firm adding "*partnership has worked well for us so far*". Interviewee B later adds that the possibility of requiring an outside auditor to examine the company "*is probably the main reason myself and my partners have decided against incorporating the auditing aspect of the firm*".

Therefore it is difficult to gauge at this early stage how many companies will incorporate the auditing section of their company, but partners agree that there are certain advantages, namely limited liability and low corporation tax rate which would apply to the profits of the company.

The respondents were asked what firms they felt the ability to incorporate would benefit most. The researcher felt this was important to ask to see how the ability to incorporate was perceived with regard to potential benefits available to firms.

All respondents felt that the bigger firms would benefit most from the ability to incorporate given the potential exposure to large costs when auditing large companies or Public Limited Companies (PLC).

It was expressed that over time most practises would incorporate the auditing part of the firm.

A major change from partnership to an incorporated company is the potential for an audit, providing the audit exemption thresholds are broken. The researcher thought it important to get the respondents views on how they would feel about an outsider performing an audit on their company, themselves knowing the detailed work that is undertaking in an audit.

Interviewees A and B did not like the thought of having an outsider audit their newly incorporated audit company. Interviewee C did not have a problem with an outsider conducting an audit on their company, but conceded that "*this would be a problem for say the Big 4*



*firms or the other larger firms*". This issue is a matter for each individual firm, and some partners may not like having outsiders examining their companies as demonstrated by Interviewees A and B. this will probably be an important influencing factor when partners are deciding whether or not to incorporate their practise, as demonstrated by Interviewee B's response.

The next question was to examine perceptions on an audit report issued by a limited liability company and whether or not the respondents felt this would reduce the value in the hands of the auditee.

Interviewees A and C believe that receiving an audit report from a limited liability company will not detract from the quality of the opinion with Interviewee C stating *"once people see that the same ... service is being delivered, ... it will just become the norm"*.

Interviewee B has a different opinion. They feel that audit work should be undertaking without the need to *"require the protection of limited liability"*.

Regulation 47 of the SAD provides for predecessor auditors to share information with successor auditors. The researcher wished to explore the impact of this new regulation on the individual's firms and to see how it impacted on work practices.

All respondents acknowledged that this was, in many instances common practice, but that legal enforcement would improve the auditing process.

Regulation 120 of the SAD states that all remuneration paid to auditors must be disclosed and categorised into the headings of audit, other assurance, tax advisory and other non-audit. The researcher wished to examine the perceptions this would have on independence. Interviewees A and B agreed that it would increase investors questioning of independence, with Interviewee C stating that *"it*

*should*" but that it is up to the perception of individual investors as to how effective the auditor is.

Regulation 57 states that the audit report must be signed on behalf of the firm, personally by the audit partner in charge. The subjects were asked their opinions on this change.

Interviewees A and C felt this would have no impact on the perceptions as it is not a reflection on the quality of work undertaken. However Interviewee B believes that it will increase investor confidence in the audit report as an individual's name is there rather than simply a company's name. It may show more accountability.

IAASA is now responsible for monitoring the audits of Public Interest Companies as opposed to the accountancy bodies. The researcher wished to examine how this change would impact on the individual's firm.

Interviewee C believed that as it represents increased monitoring it will improve the audit of these companies. However Interviewees A and B do not agree. Interviewee A believes that the accountancy bodies providing strict enough monitoring of these audits, while Interviewee B believes that *"local, small regulation is not effective"* that a *"European regulatory framework for the auditing profession"* is required.

The researcher felt this was an important question to get respondents views on regulation.

The above questions were asked to get information on the Statutory Audit Directive to enable the first research question to be answered.

The second research question concerned potential changes that the individuals wished to see made to the auditing process.

One vehicle driving change in this area is the issuance of a European Union Green Paper. The researcher felt it was necessary to explore the

respondents views about potential changes put forward by the Paper and how they felt these would impact on the auditing process. The researcher wanted to examine if they felt the changes would be for the betterment of the auditing process or if other more appropriate changes should be made.

Respondents were firstly asked if they were aware of how the process of the issuance of a European Green Paper operated.

Interviewee C was aware of how a Green Paper is issued, however Interviewees A and B were not, with Interviewee A saying the *"maybe the larger audit firms may look at matters at a European level"* and Interviewee B adding that *"it is more important for my firm to learn what is actually coming into law for the relevant accounting periods for which we are undertaking work"*.

This was important information in order to understand the respondents' level of knowledge of the process.

The respondents were then asked as to what correspondence the professional accountancy bodies release concerning these matters. All respondents are aware of the journals, for example Accountancy Ireland, which detail these matters. It appears that ensuring compliance with newly introduced laws or regulations is more important to the respondents than partaking in changing the process of how the statutory audit is undertaking, as eluded to by Interviewee B's comments.

Interviewee A, from the smallest practise in terms of employees and number of audits conducted, feels that it should be left to the larger auditing firms to make suggestions, and perhaps feels insignificant on the grand scale in which such a change to the process occurs.

However interviewee B believes that everyone should have an input into the process, in order that smaller companies needs are met.

Interviewee C feels that the process is conducted so that whoever

wants to have an input in the process can, if they choose to take the time.

This was necessary to see if the respondents knew where to find the information if they so wished.

One potential change highlighted in the Paper is the possibility of mandatory audit firm rotation, as opposed to audit partner rotation as is currently the case. The researcher wanted to see how this potential change ranked as a viable possibility in the eyes of the profession and the effect it would have on the audit process.

Interviewees A and B believe that mandatory rotation should occur in order to have a more effective audit as *"the current firm will be conscious of a successor firm following on and reviewing their work"*. However Interviewee C believes this will not solve the problem. They believe that increased *"independent monitoring"* would be more appropriate and lead to a more effective audit.

A further change highlighted is prohibiting the auditor from supplying any non-audit services, for example accounts preparation, consultancy. This is similar to the system in operation in the USA. The researcher wished to examine if the respondents felt this would be a change for the betterment of the audit process.

All Interviewees are in agreement that in large companies and PLCs, there should not be provision of additional non-audit services by the firm who are responsible for auditing the company. They feel this is a breach of independence and may compromise their position when conducting the audit or issuing an opinion. The respondents are in agreement that in smaller companies provision of additional non-audit services is not a concern.

The Paper presents the possibility of auditors detailing the materiality level to which the audit has been conducted on the audit report, as a way of increasing communication to stakeholders. The researcher felt

this was an important question to put to the respondents to discover their views.

Interviewee A believes that it should be disclosed, as it details the parameters to which the audit has been conducted. However

Interviewees B and C have a different opinion. Interviewee C states that detailing the materiality level may cause more confusion to the stakeholders who may *"not understand specific issues relating to a particular job or that significant differences in Materiality can exist between jobs but still provide the same service or assurance"*.

Interviewee B has a different argument against disclosure of the materiality level. They believe that such information, in the hands of the wrong people could be used against the company in order to commit fraud as *"they know at what level the auditor will not look for"*. One suggestion is that materiality should be better explained on the audit report so that investors become more aware of what an audit is.

A similar proposal put forward by the Paper concerning extra reporting by the auditor to improve communication by the auditor is to verify on the audit report what elements of the accounts have been verified. The researcher wishes to examine the viability of this in the opinions of the respondents.

The responses here followed a similar pattern as to the previous question, with Interviewee A thinking that these areas should be disclosed but Interviewees B and C discouraging of this amendment. Again Interviewee A believes it would establish the parameters as to what has been verified. However Interviewee C believes this may also lead to confusion *"if we verify one area in a certain audit and do not do it in another audit"*. Interviewee B is of the opinion that this information could be used against the company by someone wishing to commit fraud. This is detrimental to the audit process.

Auditors are now being asked to become more forward thinking by presenting certain issues to the stakeholders that may happen in the

future. The researcher felt it important to get the views of the respondents as to how they would feel in providing assurance on something which has not even happened yet.

Interviewee A believes that the role should become more forward looking, *"to give opinions not just on the financial statements, but also on areas such as the company's internal controls, corporate governance arrangements and the financial assumptions underlying the business model"* and *"views on the general economic and financial outlook of the company"*. They feel this may reduce the "Expectation Gap" that exists between what an audit is and what it is perceived to be by stakeholders. However Interviewee B believes, and Interviewee A agrees, that stakeholders need to better educate themselves as to what an audit is and what it does.

Interviewees B and C stated that the standards to which they work means they must look ahead for the next 12 month period for "going-concern" issues which may arise, but Interviewee B concedes that this, especially in the current economic climate, is difficult. They give the example of a company which may lose a key supplier or source of credit being put into difficulties.

On the issue of Public Interest Companies, it is proposed that an independent third party is set-up to select the auditors for such entities. The researcher wanted to know how the respondents would feel dealing with such a party and factors which would be important to its success.

Interviewee A believes the procedure should be used, but "the selection process was transparent and based on a defined set of parameters, whereby every tendering audit firm has equal opportunity, this should make it better". Interviewee B was more sceptical, afraid the process may become corrupted, with interviewee C wanting more effective independent monitoring of the profession.

Another proposed change for the audit of such entities is a "joint audit". The researcher wanted to see what the respondents felt about this as a proposition as to how these institutions are audited.

Interviewees A and B believed that it would improve the audit of such entities, however Interviewee C conceded that it may be *"very hard to manage and perhaps the responsibility for the audit opinion may be diminished"*.

The researcher wished to find out what the respondents felt was the value of an audit to small company and its future in this context.

All respondents conceded that an audit was of little value to such a company as the management are generally able to keep tabs on how the company is performing. Interviewee A believes that it may identify areas of weak management or areas susceptible to fraud as the only possible positives which could be taking from it.

The researcher then wanted to know if they believed the current Audit Exemption Thresholds should be raised, as respondents conceded that it is of very limited use to the company.

Interviewee A believes the limits are satisfactory at present, but would not like to see them reduced. Interviewees B and C believe they should be raised in order to relieve further smaller companies from the burden of audit, with Interviewee B adding that the actual criteria for audit exemption needs to be looked at, for example company limited by guarantee.

The above questions needed to be asked in order to examine what potential changes should be made to the auditing process, to satisfy the second research question of the dissertation.

The final research question explored risks that the subjects perceived were important in the context of the profession and the auditing process moving forward.

Interviewee A believes that intently deceiving the auditor and lack of independence are the biggest risks to the auditing profession. They expressed concern that only 5% of the transactions of Anglo Irish Bank could have been verified during the last audit.

Interviewee B believes that accounts being prepared by people who are not qualified, i.e. accountants is a danger to the future of financial reporting and the audit. They are also fearful of the audit report being discredited by people not accepting the work auditors do as efficient or effective. They are also concerned that self-regulation is not effective enough to monitor the profession and does not give a good impression to stakeholders and the public.

Interviewee C believes that failure to improve independent monitoring of audits is a significant risk to the future of the statutory audit, adding that the process is inherently risky due to sampling, and that *"the cost of providing 100% reliable audit assurance is prohibitive"*. These are important issues to discover as if the issues are known, potential safeguards can be developed and implemented.

In light of recent auditing scandals, the researcher wanted to know that if another scandal broke, did the respondents feel the auditing profession could recover, as this could spell the end of the profession.

Interviewee A believes that *"the audit profession would lose all creditability and therefore would need root and branch reform"*.

Interviewees B and C believe that the profession could recover, as stated by Interviewee C that *"sometimes circumstances mean that wrong opinions are sometimes given"*.

This was important information to question as the researcher wanted to examine how secure it is perceived the future of the audit is.

The researcher will present recommended courses of action and conclusions in the following chapter.



## 5 Conclusions and Recommendations

### 5.1 Introduction

The purpose of this chapter is to summarise the main findings discovered by conducting the primary research and to draw conclusions based on these findings. The researcher will then issue recommendations derived from the findings. Potential areas of future research are suggested.

The researcher conducted the research to gauge how the Statutory Audit Directive was being received by the profession, what changes should be implemented and what potential risks to the future of the Statutory Audit exist. The researcher found little literature in the area so felt it was necessary to undertake the research in order to spark debate in the area.

The research questions of the dissertation were:

1. In light of the recent Statutory Audit Directive (SAD) 2006/43/EC of the European Parliament and the Council, what effects will it have on the auditing process in your firm?
2. Given your experience of the current audit process, what changes would you like to see implemented in the auditing process?
3. In your opinion, what are the biggest risks to the future of the auditing process in your firm and what are possible ways to negate these risks?

### 5.2 Conclusions/Recommendations

Dealing with the first research objective. It is at too early a stage to determine how many firms are going to incorporate, however findings are consistent with the literature as Spicer and Fahy (2011) identify the areas to consider are the lower corporation tax that would be applicable and increased administration requirements, as were

highlighted by the respondents. The possibility of an outsider auditing the company is also a turn-off for the partners. The researcher concludes that it is most likely going to be the larger practises which benefit from the ability to incorporate, because of the large companies they undertake audits of.

It can be expected that the delivery of an audit report from an incorporated audit company will not detract from the quality of the opinion, as discovered in the findings.

The necessity of predecessor auditors to share information with successor auditors is being welcomed by the profession.

Categorised disclosure of remuneration paid to auditors will improve the quality of the audit process, according to the results of the primary research.

Mandatory audit firm rotation for PLCs would be welcomed by the profession as this can be seen to increase independence and increase stakeholder perceptions of the effectiveness of the audit. This is consistent with the Commission's beliefs on the matter.

It can be concluded from the findings that increased regulation is wanted by the profession, as the respondents felt that self-regulation and national regulation are not effective. This goes against what Costello (2010) and Powell (2010) as they believe the auditing profession itself should take more responsibility to ensure independence, appearing to favour more self-regulation. However as demonstrated some of the profession would actually like more increased independent regulation, as they feel it would increase stakeholder confidence in the audit process. It is recommended by the researcher that the interested parties, particularly the European Union look at ways of implementing greater regulation as a way of restoring investor confidence in the audit.

The Statutory Audit Directive has had a significant impact on the firms investigated and has developed a few issues for them. The researcher believes the changes made will be successful in improving investor confidence in the audit.

With regard to the second research question. The researcher feels that an appropriate vehicle is in place to allow all interested parties to partake in the discussions on possible changes to the statutory audit process.

In PLCs and other Public Interest companies, it is recommended that provision of non-audit services by the auditor should be prohibited, in line with findings, as this would increase independence and the perceptions of stakeholders.

With regard to materiality and publishing of verified elements of the financial statements, the researcher proposes that the level and elements are not disclosed on the audit report, due to concerns highlighted by Interviewee B, but that a better explanation of materiality, and the use of sampling and judgement by the auditor should be provided on the audit report, to clarify any misconceptions stakeholders have about the audit process. This is in conflict Costello's (2010) belief that materiality should be disclosed. This additional substance may go some way in reducing the "Expectation Gap" identified by Liggio (1974). This may also reinforce McAlpine's (2010) opinion that the current audit report format needs amending. Auditors providing information on certain future events would be welcomed; however the researcher feels that the auditors may be wary of this as they would be verifying or commenting on something which has not yet occurred. This information should be highlighted to investors by the auditor however, through the vehicle of another disclosure separate to the audit report.

It is recommended that "joint audits" should be implemented for Public Interest companies, in order to increase investor confidence in the audit reports of such entities.

It is recommended that the Audit Exemption thresholds are further raised and that the criteria for deciding which companies are exempted is looked at by the relevant law-makers, as the audit is viewed as unimportant for certain smaller companies falling into

audit. These findings are in agreement with Lambe and Kenny's (2010) belief that the status quo is not acceptable.

Upon investigation of the final research question the researcher wishes to make the following recommendation. As already stated, additional monitoring would be effective in increasing levels of independence and hence, investor confidence on the audit report.

### 5.3 Areas of Future Research

As the research was conducted as part of the requirements for the Master of Arts in Accounting degree, certain limitations were placed on the research, namely lack of resources, constricted time and availability of respondents.

The researcher feels that a potential area of future research could be to examine all registered auditors in Ireland to examine how they feel the changes in the Statutory Audit Directive have impacted on their firm. There is also the potential to examine respondents in other European Union countries, as the Statutory Audit Directive is binding in their jurisdiction, and compare the results.

The respondents could be questioned on potential changes they feel should be made to the Statutory Audit process in order to make it more effective for stakeholders. This could then be presented to the relevant law-makers and regulators.

#### 5.4 Conclusion

This dissertation has aimed to provide an insight into contemporary issues surrounding the statutory audit process. After conducting primary research, the findings have identified several recommendations and conclusions in an attempt to answer the research questions identified. Certain limitations of the research however have been highlighted. Potential areas of future research have been identified by the researcher in an effort to increase the knowledge that exists on the issues.

## Appendices

### Interviews

#### Interviewee A

1. How many people are employed by the firm? 2
2. How many audits are conducted each year (approx.)? 10-12
3. Are you aware of the recent Statutory Audit Directive signed into Irish Law on 20<sup>th</sup> May 2010? Yes – basically it states that audit firms can now incorporate. It also states that an individual must sign the audit report issued for the company, there is now a duty that Auditors must provide "transparency reports" when auditing certain large entities. There is also the requirement to provide information to new auditors.
4. Would you incorporate the auditing part of your firm, advantages/disadvantages? It is currently being considered as a possibility for the practise, both from a limited liability and tax planning perspective. The Advantages are Limited liability and Tax Planning opportunities and the low corporation tax rate. The disadvantages are the additional corporate responsibility and Company Secretarial obligations, so we have to evaluate whether it is worth it or not given the small volume of audits we conduct every year.
5. What firms do you think it will benefit most? There are certain benefits for both large and small firms; however large firms should benefit the most from the change, because of their exposure to potential large liability when auditing large companies and PLCs.
6. Do you foresee many firms incorporating the auditing branch of their firms? Large firms or small firms? Over time yes, but many will have to consider the legal implications first and may possibly adopt a wait and see approach to see how many of the competition incorporate. Many may not like the idea of having external auditors reviewing their practice
7. If your incorporated audit company required an audit, how would you feel about a member of the competition auditing your company? Not great. I think I would consider getting an auditor from another county with no local interests, not doing any business in the area or my jurisdiction to conduct the audit as it reduces the risk of giving out important information about clients. It is to keep the integrity of the clients.

8. Do you think being audited by an incorporated audit company will be perceived as improving/detracting the audit process because of the limited liability concept? No I don't. I think the idea of partners personal responsibility in the event of liability is an antiquated concept, particularly considering the litigious society we now live in and stakeholders will appreciate that equal care has gone into preparing the audit regardless of limited liability.
9. Do you think the requirement for predecessor auditors to share information with successor auditors will improve the audit process? In theory yes, but up till now most firms will provide this information anyway, but it is just putting a legal necessity on the transaction, but it should improve the process as you are perhaps getting alerted to potential areas of danger or more arduous areas.
10. Do you think auditors having to disclose how much they receive under each heading (tax, audit, other assurance) will make investors question how independent the auditors are? Yes I think it will. I think investors will question independence if large fees are received for tax /other assurance vis a vis the audit fee.
11. Do you think the audit partner having to sign the audit report personally will increase investor confidence in the audit opinion? I can't see it making much of a difference because most auditors take great care in preparing their work anyway. However it is possible to dupe an auditor if a company so wishes, particularly in large entities, where it is impossible to audit each and every transaction. An auditor can fulfil the requirements of an audit and still give the wrong opinion. Therefore having an auditor personally responsible will not materially reduce the risk if a client is intently pulling the wool over the auditor. We just have to hope that the auditor catches it.
12. Another change is the way Public Interest companies' (large PLCs & Financial institutions) audits are inspected. It is now up to IAASA to monitor these audits, not the professional accountancy bodies; do you think this will improve the audit of these entities? I think that is unlikely, as in my own experience and anecdotally talking with other auditors, the professional accountancy bodies are extremely strict with their practicing audit members. And most auditors carry out their duties with the utmost care. Again as before if a company intently dupes an auditor it can cause difficulties.

13. Are you aware of how the process of the issuance of EU Green Papers works? No, I rely on the professional body to keep me informed on these matters. Maybe larger audit firms may look at matters at an EU level, but the accountancy bodies do a good enough job in my opinion.
14. What correspondence does the professional accounting bodies issue in relation to an EU Green Paper? Reasonable correspondence outlining the concepts that are proposed or are being introduced and the requirements of these in the monthly journals, so we know what we have to do for the current accounting period.
15. Are you happy with the way this process is conducted? Again maybe larger firms may have issues, but for our purposes, its basically irrelevant so I have no feelings either way.
16. Do you think practising accountants/auditors have enough input in the process? The professional bodies have given input, but I'm not sure if its enough, perhaps more advice should be taking from these than law makers and regulators.
17. Do you think there should be mandatory audit firm rotation as opposed to audit partner rotation after 7 years, and after how many years should they be rotated? I think there should be Mandatory Rotation of firms, which in theory, should lead to better audit practice as the current firm will be conscious of a successor firm following on and reviewing their work. I feel that 7 years may be too long, 5 years may be more appropriate.
18. Should auditors be allowed to provide non-audit services (tax, accounts preparation, consultancy) when providing the audit? This is a difficult area. Auditors should be independent and therefore not provide tax accountancy etc to audit clients. However by doing this the compliance cost for audit clients will be adversely affected if they have to "shop around" for tax/accounts prep advice, particularly if the audit client is a small firm which requires an audit (management company, company limited by guarantee etc). But certainly for public interest companies auditors should be independent and therefore I do not think they should provide additional services to a company they are auditing.
19. Should the materiality to which the auditors work be disclosed on the auditor's report? Yes I think it should, as the audit should



be an independent and an honest view of the company, by disclosing the materiality that we work to sets the parameters for the audit and gives assurance to the stakeholder and readers of the financial statements as to their accuracy.

20. Do you think that components of the accounts which have been verified should be published in the audit report? Yes I think they should, again to show independence and establishing what has been verified provides confidence to the stakeholder and highlights what areas have not been verified, and how much work the auditor has put in to the audit.
21. Would you be happy reporting/disclosing information on certain future events which may affect the audited company? What information do you feel would be important for investors to know/be made aware of? I would agree that the role needs to evolve to take into account more forward-looking information, and for the auditor to give opinions not just on the financial statements, but also on areas such as the company's internal controls, corporate governance arrangements and the financial assumptions underlying the business model. I think that by doing this, auditors will better meet the needs of stakeholders who are calling out for the auditors views on the general economic and financial outlook of the company. This will help address the so-called "expectations gap" of auditing by providing more information to the stakeholders.
22. Do you think investors need to better educate themselves as to what an audit actually involves, not what they think it involves in order to address the expectation gap also? Yes I think perhaps they should try to understand a little better the use of sampling, judgement and materiality as concepts central to how audits are conducted, and that they are for the good of the company and shareholders but also not to put excessive costs on the company.
23. Do you think the process of a third party selecting an audit firm for say, a bank, or other important financial institutions should be implemented? Yes in general. If an independent or statutory government body was set up to carry out that function and the selection process was transparent and based on a defined set of parameters, whereby every tendering audit firm has equal opportunity, this should make it better.
24. Do you think "Joint Audits" should be used for such important institutions or public listed companies? Well essentially this is a review situation and while it may lead to effectively double audit

fees for the "auditee", it would bring further confidence to the audit report, the fact that two firms have examined the company.

25. How important do you think an audit is to a relatively small company run by its owner and what areas do you think it provides value in such a company? Audits provide relatively little additional value to an owner managed company, over and above standard financial statements preparation. Perhaps it may identify areas of weak management or maybe identify fraud within the company by employees etc. but a good owner manager should see these issues anyway.
26. Would you like to see the audit exemption thresholds reduced/increased, why/why not? The thresholds are reasonable at present, there certainly is no argument to have them reduced as this only increases the compliance costs for already struggling firms.
27. What do you think are the biggest risks to the auditing profession, for example another Enron-type scandal? How do you think these could be prevented? The lack of independence is the first risk and intentional deceiving of the auditor as seen by the recent bank scandals, whereby loans were covered up, are the biggest issues threatening the profession at present. It could be argued that in some of the giant companies, unless there are full time independent auditors reviewing all material transactions, it is very difficult to too uncover all unethical or even illegal practices in the course of a normal audit. It has been stated that the last audit on Anglo Irish Bank less than 5% of all transactions could have been audited in the time permitted.
28. Do you think the auditing profession could recover from another Enron-type scandal? If another scandal of that nature broke, I feel that it is likely that the audit profession would lose all creditability and therefore would need root and branch reform. It is difficult to see how the profession could recover without complete overhaul.

## Interviewee B

1. How many people are employed by the firm? 15
2. How many audits are conducted each year? 40
3. Are you aware of the recent Statutory Audit Directive signed into Irish Law on 20<sup>th</sup> May 2010?  
Yes. It is important as practising, competent auditors in the profession that you keep up to date with all new laws and regulations which come into effect and to which the firm must abide by otherwise you could be leaving yourself open to litigation. It means auditors have to personally sign the audit report, and have the option of forming limited liability companies. These are the two most pressing areas which have impacted on our firm.
4. Would you incorporate the auditing part of your firm? No.  
Although there are advantages such as limited liability and lower corporation tax payable, I feel that partnership has worked well for us so far and currently our firm does not envisage incorporating the auditing element of the practise.
5. What firms do you think it will benefit most?  
I feel it depends on the client base of your firm. I foresee a lot of the larger firms incorporating, as they undertake audits for some really large scale companies and even public listed companies and so are leaving themselves open to large liability. The "limited liability" concept will certainly help these companies and reassure their partners a bit more, with regard to potential losses and litigation. But currently our set up satisfies our needs adequately as our clients are of a smaller nature, and they are easier to handle than a large PLC with regard to number of transactions and desire to commit fraud.
6. Do you foresee many firms incorporating the auditing branch of their firms? Large firms or small firms?  
I feel it will be more the larger firms incorporating the auditing part of their firms because of the potential for litigation and large payouts required from indemnity insurance.
7. If your incorporated audit company required an audit, how would you feel about a member of the competition auditing your company?  
This is probably the main reason myself and my partners have decided against incorporating the auditing aspect of the firm. We feel it would be inappropriate for us to allow our competition access to our work practises, accounts, client lists and prices

charged as it could result in the loss of customers. Not allowing outsiders access to our accounts is one of the major advantages to having a "partnership".

8. Do you think being audited by an incorporated audit company will be perceived as improving/detracting the audit process because of the limited liability concept? Yes, I feel it will detract from the quality of the audit opinion as it is being issued by someone with limited liability when it comes to them stating their opinion. I feel the person/firm should be confident of issuing the opinion without using the protection of "limited liability". They should be conducting their work in a professional manner and if so should not require the protection of "limited liability".
9. Do you think the requirement for predecessor auditors to share information with successor auditors will improve the audit process? Why? Yes I think this will improve the audit process, and I will give you a tangible example. Recently we conducted an audit of a company, and although firms generally do allow access to some papers, having access to all papers from the predecessor auditor really allowed us to get to grips with the assignment much quicker. I feel we did do a better job because we had the access to their previous working papers used for the audit. And more importantly for the client able to do a cheaper job as it took us less hours to complete the audit. This is an important aspect for the client, especially in the current economic climate where they are monitoring costs closely and accountancy fees can sometimes be perceived as excessive as management believe they are not adding value to their operations but rather just compliance so to be able to charge a lower amount to the client certainly improved our relationship and saved some hassle for us here in the firm with regard to collecting fees. This will allow us but also force us, and other firms, to become more efficient and more competitive in order to do a better job for our clients at a keener price.
10. Do you think auditors having to disclose how much they receive under each heading (tax, audit, other assurance) will make investors question how independent the auditors are? I think this is right. The facts are the facts and they should be disclosed to the interested stakeholders and these are important areas/issues. I think potentially they could be seen as less independent because of the amounts they receive from providing these other services so this will give investors something to think about so hopefully this step will improve the audit process and value of the audit report. There is no point people hiding how much money they are getting from the audit and then putting it onto other sources, for example charging X for an audit but then

compensating by charging excessive fees for tax compliance in order to make up for it.

11. Do you think the audit partner having to sign the audit report personally will increase investor confidence in the audit opinion? Yes I think it will as they are seeing a name rather than just, say PriceWaterhouseCoopers.
12. Another change implemented is the way Public Interest companies' (large PLCs & Financial institutions) audits are inspected. It is now up to IAASA to monitor these audits, not the professional accountancy bodies, do you think this will improve the audit of these entities?  
Not really no, the Chartered Accountants Ireland Regulatory Board (CARB) is strict enough. I do not see how IAASA will be any more beneficial. I think the audit monitoring system needs to be bigger than the country, for example European-wide. When you have so very few dominant firms, the Big 4, CARB or IAASA, are no good, I feel it is just a change of name for the same current existing structure, what I feel is needed is a European regulatory framework for the auditing profession so that if a member of the Big 4 is doing a job in Ireland they have profound implications throughout their network in the European Union and as far as regulation is concerned I believe, local small regulation is not effective. Its the same situation with the banks. Having 2 or 3 banks they have too much power and of the 4 audit firms they have too much power, so to me it is not dealing with the issue whatsoever. I think European Regulation is required.
13. Are you aware of how the process of the issuance of EU Green Papers works? No I do not have any knowledge of how this process is undertaking. I feel it is more important for my firm to learn what is actually coming into law for the relevant accounting periods for which we are undertaking work.
14. What correspondence does the professional accounting bodies issue in relation to the EU Green Paper? I think they detail these issues in the journals they produce but I tend not take much interest in these and concentrate more on the newly signed laws or regulations to which we must abide and ensure that our staff are in compliance with these. For example with the SAD, from X date or accounting period starting on this date such and such will be enacted, like personally signing the audit report, so it is like it's a full year before the necessary regulation is implemented so change takes a long time in this profession. So whatever audit you do it is going to be the next year before you ensure compliance with said regulation and sign the audit report.

15. So do you think this should be the task of larger accountancy firms rather than small firms? No I think everybody – large firms and small firms- should be inputting in the process. I am aware that there is a process that they send things out, Exposure drafts or what have you, saying this is going to be changed with regard to tax and so on, what is your opinion on this and I do feel it is important that everyone has an input. But I feel that sometimes larger firms have a very standardised input especially with an EU approach, where they believe on size fits all and certain changes should be applied right across the board. They may have little regard as to what effects these changes will have on smaller companies as much of their clients are larger firms, so for this reason I feel it is important that everyone has a say in the changes that are being made.
16. Do you think there should be mandatory audit firm rotation as opposed to audit partner rotation after 7 years, and after how many years should they be rotated?  
No I do not see how this will improve the process for smaller firms anyway as it is useful to build up relationships with your customers in order to provide a better service. I would not like to be losing clients I have had for 7 years as I would have to be more active in looking for new clients and I do not feel it detracts from the work we do at present, to be associated with a client for more than 7 years. For larger companies this may be useful and I would agree with mandatory rotation of audit firms after 7 years for PLCs and Banks.
17. Should auditors be allowed to provide non-audit services (tax, accounts preparation, consultancy) when providing the audit?  
Yes they should so long as it is fully disclosed I think it is not a problem and does not detract from the audit process. I think the auditor providing consultancy services or acting as management should not be allowed though, as this would breach or compromise their position in the organisation/company. I think allowing auditors to provide those other services (tax and accounts preparation) could improve the quality of the audit as if they know they are providing that service they will ensure that it is done correctly anyway within the firm. This can reduce costs for the company and the advantages of this have already been explained. The auditors provision of these other services can improve the audit as they become more aware of how the company operates and can gain more of an understanding of everything about the company, for example the mentality of management and culture of the organisation and perhaps the potential amongst employees/management for fraud and the potential areas where fraud may occur.

18. Should the materiality to which the auditors work be disclosed on the auditor's report? This has been discussed by regulators and law makers. No I don't think that it should be disclosed on the audit report. There are two sides to this issue. If an investor can look at the audit report and see that this is the figure/accuracy to which the auditor worked and so these figures/amounts should not be left out of the accounts this should improve communications between the parties. But if someone within the company wants to commit fraud, they know at what level the auditor will not look for so, for example if they want to embezzle monies, they distribute the payments in figures/sums at less than the materiality level to which the auditors work, so it cuts both ways. Perhaps the audit report should better explain materiality or what it is, but to give a value I do not think that this should happen.
19. Do you think that components of the accounts which have been verified should be published in the audit report? This would be more detail on the audit work the auditor has undertaken. No I think for the same reasons as before, giving the information to the wrong people. In our audit plans we set out that a certain percentage of fixed assets, receivables, creditors, suppliers, bank reconciliations, etc, have to be verified. However I do not think that this information should be disclosed as certain information can be manipulated for other people's more sinister benefits as well.
20. So do you think that investors need to better educate themselves with the audit reporting process and contents of the auditors report? Yes I feel they need to be better educated. What may be useful is an explanatory note or statement on what materiality is, explain it, a statement on how an audit process takes place, and how sample based techniques are employed by the auditor and they do not look at every transaction. There needs to be an explanation that materiality, judgement and sampling are used and all the work that auditors do is linked together.
21. Would you be happy reporting/disclosing information on certain future events which may affect the audited company? We currently look at possible events for the next 12-month period that the audit report is signed; we do look ahead and look for possible difficulties. The audit report is to provide assurance on what has happened up to that date, such as these are the right figures. But going concern we examine issues like is there enough money to keep the business going.

What information do you feel would be important for investors? Going concern issues are key for investors. Issues do arise for the company, but beyond 12 months it is very difficult to foresee or plan for or disclose for. Even within 12 months is difficult, I have had companies that within 3 months have gone from being in a very secure situation to a situation where it may not exist or survive – perhaps because of loss of a key client. This is topical now with companies regularly going out of business, or a depression in the market, or withdrawal of finance from the bank.

22. Do you think the process of a third party selecting an audit firm for say, a bank, or other important financial institutions should be implemented? I thought this was the task of the audit committee. It would depend on who the third party was, certain elements of governments have been proven to be corrupt so this could be another area subject to this and this would not be adding value to the audit process. But no I feel it should be left to the audit committee and the firm should be changed every 7 years.
23. Do you think "Joint Audits" should be used for such important institutions or large PLCs? Yes I think this is a good idea and should improve the audit of such large institutions and provide more assurance to stakeholders.
24. How important do you think an audit is to a relatively small company run by its owner and what areas do you think it provides value in such a company? I do not think it is at all important to such a company; the limits are now so high that it has excluded a lot of family owned companies. I do not see any benefits for such a company to have an audit. I believe that it is more important that the accounts are prepared by qualified registered accountants and meet the companies acts; I feel this is more important rather than an actual audit. Sole traders do not have to audit their accounts and I know some sole traders who are as big as some of the companies which require an audit but the sole trader does not.
25. Would you like to see the audit exemption thresholds reduced/increased, why/why not? I would like to see them increased in order to reduce the burden of an audit on these companies and as I said with regard to the sole traders, they do not require an audit, so it should be left up to the individual management to decide on whether or not they would like to have an audit. I would like to see the requirements for audits looked at again, for example, small charities or a company limited by guarantee have to have an audit and cannot claim audit



exemption even though they may only have a turnover of €100,000.

26. What do you think are the biggest risks to the auditing profession, if there is one thing you think that is going to be a problem? How do you think these could be prevented? I believe that there needs to be a regulation where it is only qualified accountants allowed to prepare accounts for companies and sole traders both, as this would improve quality of preparation and make the statements more valued by users. For example a company fulfilling the audit exemption requirements with turnover €6 million, 40 employees, net assets €2.5 million, can have their accounts prepared by unqualified people. For example there needs to be a similar system as to what is operated in the USA. We need to have more tax audits for smaller owner-managed companies as they want to ensure compliance with tax system so that they do not get fined for non-compliance. The accounts are prepared for the taxman and the bank is just secretary. The biggest risk to the auditing profession is the complete discredited audit report. The audit report needs to be focused, kept very specific. There is no point us saying we are auditing something we cannot audit.
27. Do you think the auditing profession could recover from another Enron-type scandal? I do not think that self regulation is a good idea, I do not think that local regulation is a good idea, I think the profession needs international regulation is a good idea, especially for PLC and the likes, such important institutions. It will survive, audits have become very checklist based and not sitting back and looking at the bigger picture. It seems to me to be very much a box-ticking exercise, not seeing the wood for the trees. Too much box-ticking and not sitting back and thinking, right how is this company going to survive.

Interviewee C

1. How many people are employed by the firm? 16 & 3 Partners
2. How many audits are conducted each year (approx.)? 40
3. Are you aware of the recent Statutory Audit Directive signed into Irish Law on 20<sup>th</sup> May 2010?  
Yes, it is an important issue for us in the last year. It allows us to incorporate the auditing part of the practise, and we must personally sign the audit reports of the audits we conduct.
4. In light of this would you incorporate the auditing part of your firm?  
We are considering it at the moment, so there is consultation going on between the 3 partners as to what our next move should be. The advantages of it are limited liability and tax planning opportunities for the practice and the partners.  
  
The big disadvantage is the hassle of re-registration.
5. Similar to the factors a sole trader must evaluate when deciding on whether or not to incorporate. Yes that's a similar situation. We think that the big one (issue) is the increased burden of filing and paperwork. Although we have a good team here so we should be able to keep on top of it should we decide to incorporate the auditing section.
6. What firms do you think it will benefit most?  
Initially the bigger firms will benefit, as they carry out audits for the larger companies, where they are exposing themselves to large potential liability in the event of something going wrong. I think partners in these firms may be interested in incorporating for these reasons.
7. Do you foresee many firms incorporating the auditing branch of their firms?  
I think that most firms will incorporate eventually, it will probably become the norm as far as the auditing profession goes. The corporation tax rate is attractive to partners, and allows for reinvestment in the practise. And as mentioned the limited liability aspect, as if other professions are allowed it we should we not be.
8. If your incorporated audit company required an audit, how would you feel about a member of the competition auditing your company?

The company would not require an audit at this point, due to the large audit exemption thresholds. However if it did I would have no problem with another company doing it, things are so standardised now that it would not be a problem. However I do see how this would be a problem for say the Big 4 firms or the other larger firms.

9. Do you think being audited by an incorporated audit company will be perceived as improving/detracting the audit process because of the limited liability concept?

I don't believe it will change the perception of the audit at all. The profession has to be so careful not to issue a wrong opinion for fear of litigation that we have to act professionally and ensure everything is in order. Once people see that the same things are being done in an audit by an audit company, they will understand that the same service is being delivered, so again it will just become the norm.

10. Do you think the requirement for predecessor auditors to share information with successor auditors will improve the audit process?

A lot of auditors tended to do this anyway, as it was, I suppose good auditor etiquette, we all help each other out as we know how difficult the work can be, so this would have been good practice anyway but yes I think it will improve the process, especially on larger or perhaps complicated audits, access to this information is useful to alert you to areas that need most attention. Not that anything sinister may be going on but just the areas that need the work to comply with the standards. But yes I suppose for auditing really large institutions, a bank, it should improve the process.

11. Do you think auditors having to disclose how much they receive under each heading (tax, audit, other assurance) will make investors question how independent the auditors are?

Maybe, it probably should as if they are receiving more than say 50% of the audit fee in other areas, it is probably going to be a significant amount and could again, compromise independence. However it is up to the perception of the investors as to what constitutes a significant amount, and of how effective they think the auditors are.

12. Do you think the audit partner having to sign the audit report personally will increase investor confidence in the audit opinion?

No not really, the firm's name would be on it so it could be found out who conducted the audit anyway.

13. Another change is the way Public Interest companies' (large PLCs & Financial institutions) audits are inspected. It is now up to IAASA to monitor these audits, not the professional accountancy bodies; do you think this will improve the audit of these entities?  
Yes, it is increased monitoring so I feel this is necessary in order to improve the quality of audits further.
14. Are you aware of how the process of the issuance of EU Green Papers works?  
Yes I like to keep informed on how these affect our profession.
15. What correspondence does the professional accounting bodies issue in relation to an EU Green Paper?  
We are notified through professional bulletins by the bodies and Accountancy Ireland run articles on the new developments or proposed developments which are going to affect the profession.
16. Are you happy with the way this process is conducted and do you think all stakeholders have enough input?  
Yes I feel it is conducted fine, they get the feedback and make amendments before issuing the standard or regulation, whatever the case may be. The parties that are interested have enough access to the process if they take the time to educate themselves or read about what changes are happening and to have an input on them via the professional accountancy bodies, etc.
17. Do you think there should be mandatory audit firm rotation as opposed to audit partner rotation after 7 years, and after how many years should they be rotated?  
No I don't believe mandatory rotation should happen at all. I think independence and standards will be better maintained through more effective independent monitoring of auditors. It again goes back to the threat of litigation, auditors have to ensure they are not leaving themselves open to liability, and increased monitoring should occur.
18. Do you think that auditors should be allowed to provide non-audit services (tax, accounts preparation, consultancy) when providing the audit?  
In small companies I don't see this as a problem, so tax and accounts preparation should be allowed as long as independence of auditor can be clearly explained. But in large companies, no I don't think that these services should be provided by the auditor. They are auditing their own preparation, and other work, so independence could be compromised, so no.

19. Should the materiality to which the auditors work be disclosed on the auditor's report?  
We Accountants/Auditors use our professional judgement to decide the level of Materiality that is appropriate on a job by job basis. I think disclosing or explaining this would lead to more confusion as accounts users, in general, will not understand specific issues relating to a particular job or that significant differences in Materiality can exist between jobs but still provide the same service or assurance.
20. Do you think that components of the accounts which have been verified should be published in the audit report?  
No, again for a similar reason as above, different areas may require more/less work, and it may confuse if we verify one area in a certain audit and do not do it in another audit.
21. Would you be happy reporting/disclosing information on certain future events which may affect the audited company? What information do you feel would be important for investors to know/be made aware of?  
The current standards that we have to comply with require that an auditor considers the impact of post balance sheet events. We also have to form an opinion on certain estimates in the accounts which relate to the future. I believe these standards are adequate if the auditor is doing his job properly.
22. Do you think the process of a third party selecting an audit firm for say, a bank, or other important financial institutions should be implemented?  
No – again I think more effective independent monitoring of auditors is the most effective way to ensure proper standards and to safeguard the future of audits of such entities.
23. Do you think "Joint Audits" should be used for such important institutions or public listed companies?  
I don't think so as they are very hard to manage and perhaps the responsibility for the audit opinion may be diminished.
24. How important do you think an audit is to a relatively small company run by its owner and what areas do you think it provides value in such a company?  
I feel that an audit has very limited value in this situation as the owner is able to keep tabs on how the company is operating themselves.

25. Would you like to see the audit exemption thresholds reduced/increased, why/why not?  
Yes – again as the audit is of very little value to small companies so these could be further raised.
26. What do you think are the biggest risks to the auditing profession, for example another Enron-type scandal? How do you think these could be prevented?  
I think improved independent monitoring will help maintain standards and reduce the risk of these scandals. However they will not eliminate these issues as the cost of providing 100% reliable audit assurance is prohibitive.
27. Do you think the auditing profession could recover from another Enron-type scandal?  
Yes, I think the profession is robust enough and people see that sometimes circumstances mean that wrong opinions are sometimes given.

## Definitions/Abbreviations

ACCA: Association of Chartered Certified Accountants

Big 4: PricewaterhouseCoopers, Deloitte & Touche, KPMG, Ernst & Young

CAI: Chartered Accountants Ireland

CPA: Certified Public Accountants

FRC: Financial Reporting Council

FS: Financial Statements

IAASA: Irish Auditing and Accounting Supervisory Authority

IAASB: International Auditing and Assurance Standards Board

ICAEW: Institute of Chartered Accountants England and Wales

ICAS: Institute of Chartered Accountants Scotland

IOSCO: International Organisation of Securities Commission

Public Interest Entity (PIE): companies whose transferable securities are admitted to trading on a regulated market of any member state (of the EU), credit institutions, insurance undertakings.

SAD: Statutory Audit Directive 2006/43/EC

SME: Small & Medium Enterprise

SMP: Small & Medium Practitioners

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